Supreme Court, U.S.
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No. 02-1829

In The
Supreme Court of the United States

CNA HOLDINGS, INC.,
f/k/a HOECHST CELANESE CORP.,

Petitioner,

v.

DELAWARE DIRECTOR OF REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The Supreme Court Of Delaware

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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BRIEF IN OPPOSITION

The Attorney General of the State of Delaware, on behalf of the respondent, the Director of Revenue, respectfully asks this Court to deny the petition seeking review of the judgment of the Supreme Court of Delaware.

OPINIONS BELOW

The opinion of the Delaware Supreme Court (Pet. App. 1a-11a) is officially reported at 818 A.2d 953. The January 9, 2002 opinion of the Delaware Superior Court (Pet. App. 12a-25a) is unreported. The February 9, 2001 decision of the Delaware Tax Appeal Board (Pet. App. 26a-35a) is unreported.

JURISDICTION

The judgment of the Delaware Supreme Court was entered March 21, 2003.[1] The jurisdiction of this Court is invoked under 28 U.S.C. §1257.

STATEMENT

In 1992, petitioner CNA Holdings, Inc., a multistate corporation, filed an amended state income tax return,

[1] Delaware appellate practice does not provide for any separate document known as a judgment. Instead, the Clerk of the state supreme court enters a docket notation based on the final paragraph of the written decision. *See* Del. Code Ann. tit. 10, §162 (Repl. 1999).

seeking a refund of more than $817,000. Respondent, the Director of Revenue, denied the refund, and after a hearing, the Tax Appeal Board ruled in the Director's favor. On appeal to the Superior Court, the decision was reversed, the court holding that the Director's reading of the statute led to an unreasonable result. On the Director's appeal, the Delaware Supreme Court reversed.

1. The State of Delaware imposes a corporate income tax, the tax being based on the corporation's federal taxable income. Under the scheme in place for nearly 50 years, income derived from an asset that can be readily identified with or attributable to a particular location is first allocated to the state in which the asset is located. Thus, patent royalties are allocated to the state in which the process is used or the item is made; gains or losses from the sale of real property and depreciable personalty are allocated to the state in which the property is located. The remainder of the corporation's net income is apportioned to Delaware according to a standard three-factor formula, premised on the percentage of the company's total asset values, wages, and gross receipts represented by its Delaware holdings and activities. Pet. App. 4a, 37a-40a.

a. In 1989, petitioner sold a chemical plant located in Delaware for approximately $26 million. For federal tax purposes, petitioner recognized a gain of slightly more than $14 million from the sale of the plant; $9.9 million was attributable to depreciation recapture and $4.1 million was characterized by petitioner as "economic gain," being the amount the plant had appreciated. Pet. App. 2a. Petitioner's federal adjusted gross income for 1989 was more than $120 million, and petitioner paid $1,224,075 in Delaware income tax, $1,218,390 representing the tax on

the sale of the plant. Pet. App. 3a. The return thus assigned to Delaware 11.6 percent of petitioner's entire income. Pet. App. 9a. Petitioner paid to other states nearly $650,000 in tax on the gain from the plant sale. Pet. App. 3a. Petitioner had also sold two other plants located outside of Delaware, but petitioner paid no Delaware tax on those sales, its Delaware tax return allocating the gain resulting from those sales to the other states.

In 1992, petitioner filed an amended Delaware tax return, seeking a refund of $817,166. The amendment removed the $9.9 million in depreciation recapture from the non-apportioned income allocated solely to Delaware and added it to the apportionable income. The amendment also apportioned to Delaware a small part of the depreciation recapture attributable to the sale of the two other plants that the original return had allocated to the other states.[2] Pet. App. 3a. The amended return thus assigned to Delaware 3.88 percent of petitioner's total net income. Pet. App. 9a. Respondent concluded that petitioner's treatment of the depreciation recapture was not authorized by state law and denied the claim. Pet. App. 3a.

b. Protesting respondent's denial of its refund claim, petitioner appealed to the Tax Appeal Board. Before the Board, petitioner complained that the allocation statute assigned an unfair amount of its net income to Delaware. Pet. App. 26a, 31a. Two witnesses testified before the Board for petitioner and the Director testified for the Division of Revenue. Pet. App. 29a-30a. The Director

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[2] The Delaware apportionment factor for 1989 was 1.12%. Pet. App. 45a.

testified that in 1989, more than 1000 corporate taxpayers had allocated gains and losses from the sale of real and depreciable personal property. Those taxpayers had allocated to Delaware $30 million in gains and $500,000 in losses; the amount allocated to other states totaled some $6.2 billion in gains and $500 million in losses. App. 5.[3] The Board affirmed respondent's decision, holding that the statute was unambiguous and petitioner's reading of the statute was contrary to the plain meaning of the text. Pet. App. 34a. Petitioner's original return for 1989 had reported gross receipts from sales and other income in Delaware of nearly $23 million and had allocated to other states nearly $78 million, out of a total federal taxable income of over $120 million. Pet. App. 28a. The Board found that the Delaware tax benefits accruing to petitioner because of depreciation deductions on the plant in earlier years amounted to $118,664 and, using average tax rates, the tax benefit to petitioner in other states came to $1,845,796, for a total of $1,964,460. App. 2. The total tax paid by petitioner in all states, including Delaware, on the depreciation recapture under the amended return would be over $1.5 million, leaving an unmatched tax benefit to petitioner of $453,746. App. 2. Even if Delaware allocated both the "economic gain" accruing from the sale of the plant and the depreciation recapture, with other states apportioning the recapture income, petitioner still had a tax benefit of approximately $97,000. When the income subjected to Delaware tax was considered in the context of petitioner's entire net income, the amount of tax stemming

[3] The Director's proposed findings of fact were adopted by the Board. Pet. App. 30a.

from the business conducted in Delaware, including the sale of the plant, was not unreasonable. Pet. App. 34a-35a.

c. On appeal to the Superior Court, the court reversed the Board's decision. Focusing on the word "gains" in the statute, the court concluded that taxing 187% of the proceeds of the sale of the plant, because of the almost double taxation of the recapture component of the gain, was an unreasonable result. Thus, despite the plain text of the statute, the court read the word "gain" to mean only the amount the plant appreciated over time plus the tax benefit of depreciation claimed on prior Delaware returns. In the court's view, this interpretation resulted in a tax liability that was consistent with the majority of the states' approach to apportionment of business income. Pet. App. 20a-23a.

d. The Delaware Supreme Court, on the Director's appeal, reversed. First, because the state tax "'piggybacks' on the federal corporation tax, . . . it follow[ed] that the definition of 'gains' for Delaware tax purposes is the same as the definition of 'gains' for federal tax purposes." Pet. App. 8a. Because for federal tax purposes, "gains" included both what petitioner labeled "economic gain" and depreciation recapture, the Delaware statute similarly included both. In that light, the statute was unambiguous.

The court then turned to whether the plain reading of the statute led to an unreasonable result. The lower court had erred when it looked at the statute in a piecemeal fashion. Instead, the correct inquiry depended on the total amount of petitioner's income that is taxed in Delaware based on the business conducted in Delaware. Pet. App. 8a. The record before the court showed that in 1989, Delaware had taxed 11.6 percent of petitioner's federal

taxable income; under the amended return, the state would tax 3.88 percent. Pet. App. 9a. Petitioner did not present any evidence about the amount of income actually attributable to Delaware activity. Pet. App. 9a; App. 4. Instead, petitioner had only pointed out that under the statutory formula employed by a majority of states, petitioner's tax would be less. According to petitioner's experts, who had testified before the Tax Appeal Board, the business – non-business apportionment formula used by a majority of states more correctly approximated the amount of income that should be attributable to Delaware. Pet. App. 9a. But the evidence showed that petitioner had actually obtained a tax benefit of over $450,000 when one compared the tax savings coming from depreciation deductions on the plant to the tax imposed on the recapture of the depreciation upon the sale of the plant. Given this result, the court was unable to say that the statute had operated in an unreasonable manner. Pet. App. 9a-10a. Because petitioner had not shown that the statute led to an unreasonable outcome, the court then concluded that petitioner had "not met its burden of proof in challenging the constitutionality of the statute, as there [had] been no showing that [petitioner's] Delaware tax [was] out of all proportion to its business activities in Delaware." Pet. App. 10a.

REASONS FOR DECLINING REVIEW

Delaware imposes on corporations doing business within the state an annual income tax. It does so on a separate company basis instead of the unitary business concept in use by most states. Under this Court's jurisprudence, a state tax levied upon multistate businesses is

valid under the Commerce Clause "so long as 'the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.'" *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358, 372 (1991) (quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)). To successfully challenge a state tax, the taxpayer must "prove 'by "clear and cogent evidence" that the income attributed to the State is in fact "out of all appropriate proportion to the business transacted . . . in that State" [citation omitted] or has "led to a grossly distorted result."'" *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 170 (1983) (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978)). Petitioner did not meet that burden, and the tax imposed in this case satisfies the Commerce Clause.

1. Petitioner's initial contention is that the tax is not fairly apportioned. Pet. 11-12. The first component of fair apportionment is "internal consistency – that is the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business's income being taxed." *Container Corp. of America*, 463 U.S. at 169. The second aspect of fair apportionment is "external consistency – the factors used in the formula must actually reflect a reasonable sense of how income is generated." *Id.* If the tax is reasonably limited to in-state business in light of the practical effects on interstate activity, the tax is externally consistent. *Goldberg v. Sweet*, 488 U.S. 252, 262 (1989).

Delaware's tax scheme, using both geographical or transactional accounting and formula apportionment, but without using the unitary business concept, satisfies the

consistency tests. Though geographical allocation might ignore or not capture many subtle and largely unquantifiable transfers of value within an enterprise,[4] it does limit the reach of the tax to only income having its source in Delaware. It is obviously internally consistent because the income can only be assigned to a single state. Allocating the gain attributable to the sale of the Delaware plant to Delaware and allocating all of the gain from the sale of plants in other states to those states (even if depreciation attributable to those facilities had been previously taken against Delaware income) limits the tax exactly to the Delaware components of the interstate business. The remainder of the unallocated income is apportioned, and Delaware's three-factor formula for doing so is consistent with tax schemes approved by this Court. *See Trinova Corp.*, 498 U.S. at 380-82; *Container Corp. of America*, 463 U.S. at 170.

Petitioner also argues that the Delaware tax scheme discriminates against interstate commerce. Pet. 13-15. In the context of interstate commerce, the anti-discrimination principle has not added much to the requirement of fair apportionment. *Container Corp. of America*, 463 U.S. at 171. Petitioner's "'discrimination' claim is simply a way of describing the potential consequences of the use of different formulas by the [several] States. These consequences, however, could be avoided by the adoption of any uniform rule; the 'discrimination' does not inhere in [any] State's formula." *Moorman Mfg.*, 437 U.S. at 277 n.12.

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[4] *Container Corp. of America*, 463 U.S. at 164-65.

The Court has rejected arguments that the Commerce Clause requires uniformity in tax schemes. Eliminating the risk of duplicative taxation would require a single constitutionally mandated method of taxation and rules regarding the application of the method in particular cases. *Id.* at 277-79. But the Court in *Moorman Mfg.* declined to adopt that reading of the Commerce Clause: not only would it "require extensive judicial lawmaking," *id.* at 278, but the prevalent practice would become the constitutional rule, an "especially unsettling [prospect] if a longstanding tax policy in one State, such as [Delaware's], becomes the object of constitutional attack simply because it is different from the recently adopted practice of its neighbor." *Id.* at 280 n.16. *See Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 444-45 (1980) (finding "no adequate justification" for a "constitutional preference for one method of taxation over another").

2. The Delaware Supreme Court decided that petitioner had "not met its burden of proof in challenging the constitutionality of the statute" because petitioner had not shown that its Delaware tax was "out of all proportion to its business activities in Delaware." Pet. App. 10a. That holding by the state court is subject to substantial deference by this Court. *Container Corp. of America*, 463 U.S. at 175-76 (citing *Norton Co. v. Dep't of Revenue*, 340 U.S. 534, 538 (1951)).

a. Petitioner's claim of multiple taxation rests upon the reports and testimony of two witnesses, Richard Pomp and Michael Lippman. *See* Pet. App. 49a-82a. Pomp's opinion was based solely upon a separate analysis of the sale of the Delaware plant and only considered the treatment of that single item of gain by Delaware and the other states. Pomp did not analyze the portion of

petitioner's income that the statute assigned to Delaware in the context of petitioner's entire income. In fact, Pomp, testifying before the Tax Appeal Board, rejected that kind of analysis as irrelevant. App. 4. His analysis did not consider the fact that Delaware law allocated outside of Delaware some $77.9 million of business income that would normally be taxed by the states utilizing the typical apportionment formula when he concluded that Delaware disproportionately assigned income from the sale of the plant. App. 4.

Lippman testified from an accounting perspective as opposed to a tax perspective. He said from an economic point of view that Delaware could tax some $118,000 of the recapture based upon the value of the Delaware tax benefit from depreciation deductions attributable to the Delaware plant. But Lippman did not extend that "matching" treatment to the depreciation deductions attributable to plants and property outside of Delaware that petitioner had claimed as deductions on Delaware returns during the ownership period. App. 5-6. Accounting systems, "though useful and necessary as a business aid," do not appreciably aid the analysis; a State has very different requirements when it seeks to place upon a business extending into several states its fair share of the burden of taxation. *Butler Bros. v. McColgan*, 315 U.S. 501, 507 (1942) (citing *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920)).

b. When petitioner complains it is being subjected to multiple taxation or to taxation of 187% of gain, it is only gain from the isolated sale of a single asset – the Delaware plant. Petitioner does not claim that more than 100% of its income was subjected to tax. That focus on an isolated business transaction is too narrow. *See Trinova Corp.*, 498

U.S. at 374-75 ("Trinova errs in the opposite direction. It would dissect the tax base as if the SBT were three separate and independent taxes. . . . "). But the issue is not whether an overlap in taxation exists because of the use of different, but acceptable, formulas for dividing a corporation's income;[5] instead, the question is whether Delaware has assigned to itself more income than it constitutionally can, taxing income earned outside its borders.[6] Before the Tax Appeal Board, petitioner made no effort to show the correct amount of income that should be assigned to Delaware based upon the business conducted there. App. 4. That shortcoming, as the Delaware Supreme Court decided, was fatal to petitioner's case, a point made by this Court in *Moorman Mfg.*, 437 U.S. at 276-77. The most that petitioner established was that if a different formula is used, a different tax – and in petitioner's case, a lower tax – would result. The fact that the tax might be lower is of no constitutional significance. Instead, petitioner had to show, by "clear and cogent evidence," that its alternative method was a more correct or more accurate measure of the business done in Delaware. *E.g., Trinova Corp.*, 498 U.S. at 384; *Moorman Mfg.*, 437 U.S. at 275 & n.9. Given petitioner's failure to make that showing, petitioner has not overcome the substantial deference due the Delaware Supreme Court's finding. *Trinova Corp.*, 498 U.S. at 384; *Moorman Mfg.*, 437 U.S. at 274; *Underwood Typewriter Co.*, 254 U.S. at 121.

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[5] *See, e.g., Trinova Corp.*, 498 U.S. at 373-74; *Container Corp. of America*, 463 U.S. at 181-83; *Moorman Mfg.*, 437 U.S. at 278-79.

[6] *E.g., Butler Bros.*, 315 U.S. at 506; *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 134-35 (1931).

3. Petitioner urges that the writ should be granted to resolve conflicting decisions on the point among the state courts. Pet. 15-19. In light of petitioner's evidentiary failure before the Tax Appeal Board and thus its failure to meet the burden of proof imposed by this Court's decisions, the resolution of any conflict is irrelevant to the ultimate outcome. As a result, the question posed by petitioner does not merit further consideration. *See Board of Educ. v. McCluskey*, 458 U.S. 966, 972 (1982) (Stevens, J., dissenting); *Boag v. MacDougall*, 454 U.S. 364, 366 (1982) (O'Connor, J., concurring); *id.* at 368 (Rehnquist, J., dissenting).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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September 2003

BEFORE THE TAX APPEAL BOARD

FOR THE STATE OF DELAWARE

HOECHST CELANESE CORPORATION	)	
Petitioner,	)	
v.	)	Docket No. 1166
DIRECTOR OF REVENUE,	)	
Respondent.	)	

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

A hearing was held in the above captioned and numbered action before the Delaware Tax Appeal Board on February 14, 1997. Hoechst Celanese Corporation ("petitioner") was present in the person of Ms. Effie Laurie and was represented by John S. McDaniel, Esquire; Elaine C. Reilly, Esquire; and Paul H. Frankel, Esquire. The Director of Revenue ("Director") was represented by Jos. Patrick Hurley, Deputy Attorney General. Prior to opening statements, a motion to sequester witnesses was made and denied and a stipulation of facts was received into evidence. The Board then heard testimony on behalf of the petitioner from two expert witnesses, Prof. Richard Pomp, and Michael H. Lippman. William Remington, the present Revenue Director, testified on behalf of the respondent.

* * *

FINDINGS OF FACT

The parties have agreed to certain stipulated facts. In addition to those facts, the Board makes the following

factual findings based upon the testimony offered and the exhibits presented.

1) The original return prepared in accordance with the instructions to Form 1100 for the year 1989 was correct and in accordance with Delaware law. The amended return which allocated the economic gain from the sale of the Delaware plant to Delaware, allocated the economic gain from the sale of non-Delaware plants outside of Delaware and apportioned all of the income from recapture of all of the plants, has no basis for such treatment in the Delaware Corporation Income Tax Law.

2) Petitioner had gross receipts from sales and other income from Delaware sources totaling $22,986,876 in 1989. See Ex.C., page 2, Sch. 3-D, line 5.

3) The depreciation deduction attributable to the petitioner's New Castle, Delaware plant produced tax benefits of $118,664 in Delaware, and using average tax rates, tax benefits of $1,845,796 in other states totaling $1,964,400. The total tax paid on the recapture income from the plant, if Delaware allocates all the income to it, and the other states apportion it, is $1,510, 654, leaving an unmatched tax benefit of $453,746 in the taxpayer's favor. See Stip. of Facts, 14, and 18.

4) The total tax due to Delaware on all income on the amended return is $406,909, which is $113,841 less than the value of the depreciation deductions attributable to plants located outside Delaware and claimed against Delaware income in earlier years. See Stipu. of Facts, paragraph 19, and Ex D, Line 13, Col. C.

5) Delaware's statutory scheme first allocates income, whether business or non-business, to the state

where the asset is geographically located or used; the remaining income is then apportioned according to a standard three factor formula. This scheme is different from the general approach used by other states under which they generally first determine the business income of a unitary business and then apportion it, while allocating non-business income according to geographic rules similar to Delaware's.

6) Pomp is of the opinion that the Delaware statutory rules for assigning income in a case involving an event that is unusual in the life of a business produce an inappropriate and improper result.

7) Pomp says this result flows from the Delaware rules which allocate the income in question instead of apportioning it, as did some 33 other states.

8) The specific inappropriate results are:

a) it produces a disproportionate assignment of income;

b) it fails to value the plant as a part of an integrated manufacturing operation; and

c) it results in discrimination because 187% of the gain from the sale of the Delaware plant is being taxed.

9) The improper result caused by the clash between Delaware's allocation rule and the national consensus of formulary apportionment should in Pomp's opinion be cured by the exercise of the discretion given the Director in section 1903.

10) This discretion should be used according to Pomp to remedy what he sees as a disproportionate assignment

of income regardless of whether or not it exceeds constitutional limitations. Pomp is of the opinion that there may well be a constitutional violation.

11) Pomp's opinion is based solely on a separate analysis of the sale of Delaware plant and includes only the treatment of that single item of gain by Delaware and the thirty three other states. Pomp accounted for the sale separately, as a discrete item of income, and did not analyze the taxpayer's entire income or the effect the Delaware statutes had on the overall assignment of a portion of the taxpayer's total income to Delaware. Pomp in fact rejects that kind of analysis as irrelevant and beside the point. For instance, Pomp's analysis does not factor in the allocation of some $77.9 million of income to states outside Delaware when concluding that Delaware disproportionately assigned income for tax purposes. To illustrate by using Pomp's pie example, Pomp focussed only on one slice of the income pie, as if it were the entire pie – *i.e.*, the income from the sale of the Delaware plant – rather than on the numerous other slices of pie making up the taxpayer's entire income.

12) No proof was offered, and Pomp's analysis did not attempt, to show the exact amount of income attributable to Delaware from all the petitioner's business activities in Delaware.

13) The transaction giving rise to the gain is not such an unusual event that the Delaware legislature did not anticipate it and specifically provide for its treatment.

14) Under the existing rules, gain from the sale of Delaware real and tangible personal property will always be subject to tax at 100% by Delaware. Gain from the sale

of Delaware real and tangible personal property that is business income will always be apportioned by other states in a fashion that is designed to tax all of a corporation's business income. Therefore, under facts similar to this case, tax approaching 200% on the gain from the sale of a Delaware business asset will always occur.

15) In 1989, the year for which petitioner requested relief, over 1000 corporate tax returns allocated gains and losses from the sale of real and depreciable tangible property. The approximate amount allocated outside of the state was $6.2 billion in gains and $.5 billion in losses. The approximate amount allocated to Delaware were $30 million in gains and $.5 million in losses. Each of these over 1000 returns were taxed according to the statutes without the application of the relief provision.

16) Lippman in his report and testimony limited his analysis to principles of economic accounting. He, as Pomp before him, looked in a narrow sense at only the acquisition, operation and disposition of the Delaware property. In his opinion the tax on the recapture income should be limited to the tax benefit derived in Delaware from the depreciation claimed on the plant. Lippman did not offer anything on the issue of the division of corporate income for purpose of state taxation, and he did not consider the application of the concept of apportionment or allocation. Lippman's opinion did not consider the depreciation claimed in earlier years from plants located outside Delaware against Delaware income. See Stip. of Facts #19. The tax saved which Lippman ignored equaled some $520,750.

17) Nor did Lippman address the discrepancy in the taxpayer's favor in total tax benefit derived from the depreciation claimed from the Delaware plant in all states, and the total tax paid on recapture gain, even if Delaware allocated all of the recapture gain to itself.

18) In contrast, Remington looked at the taxpayer's entire net income, not just the income attributable to the sale of the plant in deciding not to exercise discretion and in his opinion the tax assigned to Delaware was fair. In addition, concerns of fairness to other similarly situated taxpayers, certainty in application of the statutes, and concerns that granting relief in a case occurring as often as this one would require granting relief in many similar cases and imposing additional tax in even more cases, and would effectively alter the terms of the statute, entered into his decision.

19) This is the first case in which the Board has been called upon to review the Director's decision not to exercise discretion under the provisions of 1903(a).

* * *